

Section III Asset Management

Chapter 7

Change in Ownership: Transfer of Physical Assets

7.1

Introduction

A Transfer of Physical Assets (“TPA”) is the sale and conveyance by deed of title to a property which has a mortgage insured or held by U. S. Department of Housing and Urban Development (“HUD”) and necessitates a substitution of Borrowers. HUD approval of the substitution is required in every case where HUD exercises control over the Borrower either as preferred stockholder, by regulatory agreement, or by certificate of beneficial interest. This chapter applies to all transactions involving the transfer of all or part of an interest in the ownership of such properties.

This chapter lays out the procedures that Borrowers, new Borrowers, and Office of Residential Care Facilities (ORCF) staff will follow to ensure that a proposed new Borrower is ready and willing to perform the duties and responsibilities inherent in HUD’s commitment to the property. The chapter will outline the applicability of the requirements to HUD’s programs, and outline the delegation of responsibilities for HUD’s staff. The criteria to determine a project’s and Borrower’s eligibility for a transfer of assets is outlined in detail. Detailed directions are provided for certain relationships involving multiple commitments.

7.2

Applicability

- A. Transactions requiring HUD’s **full review** of a project, its current Borrower, and the qualifications of the new controlling entity include, but are not limited to, projects demonstrating the following characteristics:
1. Transfer of title from the Borrower entity to a buyer, including conveyance by installment sales contract, land contract or wrap-around mortgage;
 2. Transfer of any interest in a partnership Borrower which causes a dissolution of the partnership under applicable state law;

3. Transfer of the beneficial interest in a passive trust which results in a change in control and management of the asset, although legal title remains in the trustee.
- B. HUD requires a **modified review** of certain transactions involving transfers of interests in entities owning properties with the following characteristics:
1. A transfer or transfers of partnership interests in excess of 50% which does not cause a dissolution of the existing partnership under applicable law, as certified by an attorney who has no identity-of-interest with the partnership, and is licensed to practice law in the state where the partnership is recorded;
 2. Addition or substitution of a managing, controlling or special member in a Limited Liability Company (LLC);
 3. The substitution of one or more of the general partner(s) of a limited partnership Borrower which does not cause a dissolution of the existing partnership under applicable law, as certified by an attorney who has no identity-of-interest with the partnership, and is licensed to practice law in the state where the project is located;
 4. A transfer of stock of a corporate general partner of a partnership where such transfer results in one person or entity controlling in excess of 50% of the stock of a publicly traded entity or closely held corporation, where such transfer results in a change of control of the corporate general partner;
 5. A transfer of stock of a corporate Borrower where such transfer results in one person or entity, other than the original controlling entity, controlling stock in excess of 50%, or an amount less than 50% where such a transfer results in a change of control of the corporate Borrower; and
 6. Transfer of a beneficial interest in a passive trust which does not result in a change in control of the property.
- C. **TPA Light Reviews** include, but are not limited to, transactions with the following characteristic:
- Change of Internal Revenue Services (IRS) Reporting Structure, i.e. when a Borrower(s) changes from Limited Partner (LP) to LLC but all principals remain the same and the Tax Identification Number is not changing.
- D. When faced with a transaction which does not fall clearly into the definition of a TPA, but which ORCF believes warrants HUD review, if any of the following questions are answered affirmatively, a TPA Application is required. Whether to perform a modified review or full review will be determined by the ORCF after addressing the following questions:
1. Will there be a change in the control of the project ownership?

2. Will a significant sum of money, being any amount that exceeds ten percent of the contract value, change hands in conjunction with the transaction?

Note that a change to ownership entities/structure can be done in conjunction with a Section 232 refinance under Section 223(a)(7) of the National Housing Act. In this situation, the required exhibits for the processing of this change are listed on the Section 223(a)(7) Firm Application Checklist posted on the Section 232 Program website.

- E. A change to ownership entities/structure is also possible prior to the final closing of an insured Note for new FHA mortgage insurance. Such situations should be discussed with the ORCF Closer – ORCF may choose to re-process the application for Mortgage Insurance or require a TPA (depending upon the extent of the change).
- F. On occasion there will be changes to entities that own the ownership entity of a property. This can create second, third or even higher levels of ownership referred to as “tiers.” These situations need to be reviewed with the Account Executive (AE) to determine if the transaction is considered a TPA and falls into one of the categories above. In any event, any changes in the higher levels of ownership (tiers) are required to be reported to HUD, Previous Participation Certifications (Form HUD-2530) must be filed and a letter delineating the transaction and organizational charts must be provided. HUD will make the final decision of what will be required in these situations as well as the type of review.

7.3

Transfer Fees

The Department imposes a fee of \$0.50 per \$1,000 of the original face amount of the mortgage to cover the costs of administrative, legal, and fiscal actions that a review entails. Applications received for a full review which are not accompanied by the proper fee will be returned without review. For applications which are reviewed by HUD and subsequently withdrawn, the fee paid to HUD will be considered earned and non-refundable.

- A. Transactions Not Requiring a Transfer Fee:
 1. Substitution of individual general partners of a partnership, if the assignment does not result in a change in the control of the project;
 2. Assignment of the beneficial interest in a trust that holds title to the project, if the assignment does not result in a change in the control of the project; and
 3. A TPA Application Fee is not required when the new owner is obtaining a new FHA-insured mortgage at the time of the transfer.
- B. Certain complex transactions involving multiple transfers may be subject to more than one TPA fee.

1. With transactions involving two transfers of title by deed, the Director of Asset Management will determine whether a second fee is required after consulting with Field Counsel.
 2. If the Director of Asset Management determines that a transaction or series of transactions have been structured to avoid paying the application fee, the TPA application will be rejected and new application(s) will not be accepted until the required application fee(s) have been paid.
- C. The same application fee is required for a transfer of interest requiring a modified review if the proposed transaction involves: (a) a transfer of more than fifty percent (50%) of the partnership (or limited partnership) interests of a Borrower; (b) a transfer of more than fifty percent (50%) of the corporate stock (or shares) of a Borrower; or (c) a transfer of the corporate stock (or shares) of a Borrower that constitutes a change in control of such entity.

7.4

Approval Authority

TPA transactions include initial and final approval stages. ORCF is authorized to grant initial and final approval to transfer proposals. The initial approval of a TPA provides the assignee with all approvals needed and conditions to be met for the TPA to be approved. However, ORCF will not grant approvals that are conditioned upon commitments being issued from other sources. In limited circumstances, HUD has the discretion to issue a letter that acknowledges (if required by a third party) that once all TPA requirements have been satisfied, a preliminary approval letter will be issued. Initial approval is usually the time when the burdens and benefits of ownership may pass to the new Borrower. All transfers of assets are subject to review using the procedures in this chapter.

7.5

Initial and Final Approval Actions

- A. Initial and final approval authority rests with the ORCF.
- B. The ORCF will review the Application for Transfer of Physical Assets (TPA) (Form HUD-92266-ORCF) and all accompanying documentation. At the end of the review process, if the attached instruments are found to be in order, and the transfer proposal is acceptable, HUD will issue a letter granting initial approval of the application. This approval may be conditioned upon any ORCF requirement plus necessary changes in the submitted documents, if any, and will authorize the execution of all remaining required instruments. It is at this point that the parties to the transaction are authorized to transfer possession of and beneficial interest in the project. The purchaser is not authorized to transfer any interest in, take possession of, or assume the burdens and benefits of ownership without the written approval of ORCF.

- C. After the initial approval letter is issued, the real estate transaction can close and all of the documents approved by HUD can be executed and recorded along with any additional items included in the initial approval letter. The TPA transaction may be completed based upon a certification by the applicant's attorney that the documents to be executed and recorded are exactly as approved by HUD. The form of the required certification is "Attorney's Certification on Execution and Recordation" (See Appendix 7.1).
- D. For final approval, certified copies of all executed and/or recorded documents, along with any additional items included in the initial approval letter, together with the final documents that were reviewed by HUD prior to initial approval, must be provided to the AE within 45 working days from the date of the letter of initial approval, unless additional time is granted by the FHA Commissioner in writing.
- E. The ORCF may grant final approval of the TPA after it has approved the final documents and determined that any additional requirements included in the initial approval letter have been met.
- F. Records in HUD's database associated with the Property ID will stay the same. There will also be no change in the FHA loan number.
- G. The Financial Assessment System (FASS) date is the date before the deed is recorded, not the date it is signed. FASS will automatically calculate the reporting periods for old and new Borrowers. However, at the time of filing of the first financial return for the new Borrower, the auditor may need to call FASS Technical Assistance and request help with changing the reporting period in the filing template that they use. Please refer to iREMS User Guide for complete details for transferring the property. After the transfer the HUD database is required to be updated with the new Borrower information, Operator, or management information depending upon the transaction.
- H. It should be noted that the previous Borrower is not relieved of the obligation to file a final financial statement from the start of their fiscal year to the day of execution of the documents. The recording of new documents shall not release sellers of liability for pre-transfer violations of their Regulatory Agreements, or for (1) funds or property coming into their hands which, by the provisions thereof, they are not entitled to retain; and (2) for their own acts and deeds or acts and deeds of others which they have authorized in violation of the provisions thereof.

7.6

Procedures for Processing a Full TPA Review

The Lender shall contact HUD to schedule a conference call between the assigned AE, the prospective Borrower and the Lender prior to submitting a TPA application in order to clarify and discuss submission requirements. Delays due to an incomplete package may be avoided if this occurs. The AE will perform a completeness review and provide the results of such review, and may return the package to the applicant without further processing depending upon what is

deficient. Please see the TPA Review Worksheets and TPA checklist on the Section 232 Program website.

A. The following items need to be discussed in the initial conference call:

1. Nature of the transaction,
2. Organizational charts that describe the transaction (highly important),
3. Identification of the type of TPA transaction,
4. The applicable checklists and appendices to this chapter,
5. Application requirements,
6. The project's current physical and financial condition,
7. Special considerations, such as accounts receivable financing and/or master lease requirements, and
8. Experience of the Borrower and its principals.

The AE will assess each of the items in this section to determine the extent of review necessary to achieve a thorough understanding of the Borrower's proposed transaction. The AE will assess the extent of review required based on project data and history. Project files must be reviewed for all projects to evaluate the Borrower and proposed Lessee/Management Agent's previous performance and acceptability, the Lessee/Management Agent operations, financial compliance and performance and physical condition of the project using available data, such as Center for Medicare & Medicaid Services (CMS) star rating, and survey performance data. If necessary, new or additional data must be gathered, being mindful that Lessee/Management Agent, physical plant and financial operations are interrelated. If problems exist, they must be identified in the application, along with proposals to adequately address the problems through the TPA process.

Processing a review entails communications with buyers, sellers, counsel for buyers and sellers, and the AE. It is imperative that replies are made as quickly as possible.

B. Project Records

The review and analysis begins with a thorough examination of the project records and database information, including Center for Medicare & Medicaid Services (CMS) and Nursing Survey Risk Reports. If the physical condition data is outdated, the star rating is less than two stars, the Survey Risk Reports rating is high, or there is serious recurring or unresolved compliance or performance problems, a risk management plan must be provided as an exhibit in the TPA application.

1. The physical, financial and management operations must be fully acceptable, or immediate corrections are proposed and funded that are acceptable to the Department.
2. Capital improvement needs will be evaluated and conditions imposed by the ORCF to ensure all capital repairs, upgrades and replacements are made. A Borrower Certification addressing when such work will be accomplished must be provided.

3. All known noncompliance and operating performance issues will be shared with the Borrower as soon as possible after the AE receives the transfer application. The Borrower must clearly understand that addressing each item to the satisfaction of the Department will be required for initial approval.

NOTE: If the TPA includes a change in the Operator, then the process will require the implementation of a new Healthcare Regulatory Agreement – Operator (Form HUD-92466A-ORCF). This form includes requirements for a Risk Management Program in Paragraph 7, and is applicable to all new Operators, irrespective of compliance or performance risks detailed above.

C. Proposed Owner/Operator/Management Agent

1. **Previous Participation Clearance.** The proposed principal(s) must apply for previous participation clearance through HUD's Active Principal Participation System (APPS), or by submitting the Previous Participation Certification. The rules and procedures for previous participation clearance can be obtained from 24 CFR Part 200, Subpart H and HUD Handbook 4065.1 REV-1). The clearance process should begin before, or simultaneously with, submission of the TPA application. If the applicant uses the APPS process, the signed signature page generated electronically needs to be submitted with the application.
2. **Requisite Experience.** Prospective owners must satisfy ORCF that they bring sufficient experience, and lessee/management expertise to successfully operate the project. HUD requires that a minimum of three years of owning, and/or operating similar or relevant projects be demonstrated for each of these entities. For a troubled project, ORCF will require an experienced owner/Operator who has demonstrated the ability to successfully own and manage troubled projects. In cases where there will be significant repairs and/or upgrades, the prospective owner/managing entity must have sufficient experience, capability and capacity to timely complete the rehabilitation requirements.
3. All organization documents that affect the transfer, including but not limited to the establishment of the new purchasing entity, alterations to existing ownership documents, lessee/management agreements, etc., must be reviewed to assure that none of the provisions of those documents conflict with HUD contracts, regulations or statutes.

D. Procedures and Requirements for:

1. Account Receivable Financing, see Production, Chapter 15 and Asset Management, Chapter 10;
2. Master Lease, see Production, Chapter 13 and Asset Management, Chapter 9.

3. Operating Lease and/or Management Agreement, see Asset Management, Chapter 8; and
 4. Project Capital Needs Assessments, see Asset Management, Chapter 3.
- E. Legal Review of TPA Proposals by Office of General Counsel (OGC). The AE and the HUD Attorney shall simultaneously review the application based on the criteria set forth in this handbook. If the proposed transaction is deemed acceptable by HUD, a preliminary approval letter shall be transmitted to the applicant. If the proposed transaction is unacceptable, the applicant shall be notified accordingly and provided the reasons for such rejection.
- [NOTE: The Borrower is not authorized to transfer any interest in, take possession of, or assume the burdens and benefits of ownership of the project without the prior written approval of HUD. If this requirement is violated, HUD reserves the right to pursue all available administrative, legal, civil, and criminal remedies.]
- F. Opportunity for Update to Affirmative Fair Housing Marketing Plan (AFHMP). HUD requires a Borrower to review a project's AFHMP (where AFHMP was required during the firm application process of the existing loan) every five years. The TPA application review process provides the Office of Healthcare Programs an opportunity to inquire of the Borrower whether such reviews were performed and the results of such reviews. Any updated AFHMPs should be obtained for HUD's records. HUD may recommend that the AFHMP be updated to reflect changes in demographics or other relevant changes in the project's marketing area.

7.7

Procedures for Processing a Modified Review TPA

- A. Routine minimum documentation that must be submitted by the Borrower to the ORCF when a modified review is required may be found on the Submission Checklist – Section 232, Transfer of Physical Assets (TPA) & Lessee/Operator/Management Agent Change (see Section 232 Program website).
- B. Note that some Modified TPAs require a fee and that fee must be included with the application. The fee is \$0.50 per \$1,000 of the original face amount of the FHA-insured mortgage. The fee is required for a Modified TPA if the proposed transaction involves:
1. A transfer of more than fifty percent (50%) of the partnership (or limited partnership) interests of a Borrower;
 2. A transfer of more than fifty percent (50%) of the corporate stock (or shares) of a Borrower; or
 3. A transfer of the corporate stock (or shares) of a Borrower that constitutes a change in control of such entity.

- C. Opportunity for Update to Affirmative Fair Housing Marketing Plan (AFHMP). HUD requires a Borrower to review a project's AFHMP every five years. The TPA application review process provides the Office of Healthcare Programs and the Office of Fair Housing and Equal Opportunity an opportunity to inquire of the Borrower whether such reviews were performed and the results of such reviews. HUD may recommend that the AFHMP be updated to reflect changes in demographics or other relevant changes in the project's marketing area.

7.8

Procedures for Processing a Light Review

Types of transfer requiring a Light Review include, but are not limited to, transactions with the following characteristics:

- A. Change of Internal Revenue Services (IRS) Reporting Structure (i.e. when a Borrower converts from a limited partnership to a limited liability company, but all principals remain the same and the Tax Identification Number is not changing.
- B. Opportunity for Update to Affirmative Fair Housing Marketing Plan. HUD requires a Borrower to review a project's AFHMP every five years. The TPA application review process provides the Office of Healthcare Programs and the Office of Fair Housing and Equal Opportunity an opportunity to inquire of the Borrower whether such reviews were performed and the results of such reviews. HUD may recommend that the AFHMP be updated to reflect changes in demographics or other relevant changes in the project's marketing area.

7.9

Special Consideration

- A. **Secondary Financing.** Any portion of the purchase price which is not paid in cash at the time of purchase is considered to be secondary financing. Secondary financing is always junior (subordinate) to another mortgage or deed of trust and can be recorded or unrecorded. Secondary financing includes all deferred financing: financing secured by the project, financing secured by collateral other than the project, or unsecured financing.

ORCF must make certain of specific determinations when secondary financing is an element of the TPA.

- 1. HUD policy permits the use of secondary financing in connection with transfers of projects in those situations in which the ORCF determines that the proposal does not jeopardize HUD's security, does not conflict with HUD's legal or programmatic interests, and will not unduly burden the project with financial debt.

2. If FHA-insured secondary financing is proposed as part of the TPA or Section 232/223(a)(7) refinance, it must meet the underwriting criteria of the applicable section of the Act. The proposed documents must not conflict with a HUD-held or FHA-insured first mortgage or the Regulatory Agreement, or the language of any subsidy agreement. ORCF will approve the use of secondary financing in a TPA only when the following conditions are met:
 - a. ORCF will not approve any transfer that includes a lien against the project without the written approval of the first Lender;
 - b. Where the consent of the first Lender to allow secondary financing is obtained, the original signed consent document must be transmitted immediately to the Office of Asset Management at HUD Headquarters for inclusion in the project's safe instruments file;
 - c. Approval of the secondary financing will not increase HUD's exposure to financial risk or loss; and
 - d. Approval of the proposal would not violate the Department's obligation to provide housing at the least cost to the Federal government.
3. **Subordination of Secondary Financing.** The second mortgage or security agreement must be subordinate to any HUD-held or FHA-insured mortgage. The following language, as appropriate, must be included:
 - a. **Security Agreement.** Secured Party, for itself and its successors and assigns, covenants and agrees that all of its rights and powers under this security agreement are subordinate and subject to the rights of [identify mortgagee] under that certain [mortgage or deed of trust] dated [date] and recorded [date], office of recordation, and under that certain Security Agreement dated [closing date], and the rights of the Secretary of Housing and Urban Development under that certain Regulatory Agreement dated [original closing date] and incorporated by reference in the above described mortgage.
 - b. **Second or Wrap-Around Mortgages.** Mortgagee, for itself and its successors and assigns, covenants and agrees that all of its rights and powers under this mortgage are subordinate and subject to the rights of [identify first mortgagee] under that certain [mortgage or deed of trust] dated [original closing date] and recorded [date], [office of recordation] and under that certain Security Agreement dated [original closing date], and the rights of the Secretary of Housing and Urban Development under that certain Regulatory Agreement dated [original closing date] and incorporated by reference in the above described mortgage.
 - c. **Payment Only from Surplus Cash.** Notes evidencing secondary financing subordinate to FHA-insured or HUD-held financing must provide that any payments from project income can only be made from permissible distributions from surplus cash.

7.10**Monitoring**

ORCF must ensure that each project is monitored after initial approval or final approval where applicable, to ensure that the conditions of approval are satisfied.

Monitoring should begin at the point at which initial approval is issued, and continue until such time as all of the terms and conditions of the transfer have been satisfied. All required documents, including the Regulatory Agreements, Riders, and/or Assumption/Assignment documents, if any, must be executed in the form as reviewed and approved and conform to the terms and conditions of initial approval.

7.11**Non-Compliance With Transfer**

HUD will use the TPA process as an opportunity to enforce compliance with regulatory agreement requirements which are not being followed and will not grant final approval of the transfer until all financial, physical, and legal requirements are met.

- A. If a scheduled payment, or repair, or other requirement of the TPA, is not made as agreed under the terms of the transfer, the AE assigned to monitor the transfer must provide the Borrower with written notice of non-compliance, and direct that appropriate corrective action be taken within the reasonable period of time specified in the written notice of non-compliance.
- B. If the deficiency is not corrected within the period of time specified in the written notice of non-compliance, the situation should be reported to the Workload Manager. The Workload Manager should immediately consider all available options to enforce compliance. Field and Regional Counsel may be consulted and, if necessary, OGC and/or the Departmental Enforcement Center (DEC) may be requested to participate in developing a plan of enforcement. The available remedies and Administrative Sanctions include: Civil Money Penalty (as expressly authorized by 12 U.S.C. Sections 1735f-15(b)(1)), Limited Denial of Participation (LDP), suspension, debarment, etc., as well as suit for specific performance to enforce the conditions of the TPA.

7.12**Project Capital Needs Assessment (PCNA)**

A PCNA (in accordance with the Statement of Work as set forth in the Section 232 Handbook, Production, Chapter 4, for a Limited Scope PCNA) and Reserve for Replacement (R4R) Analysis are required with a TPA in the following situations:

- A PCNA or comparable reserve analysis has not been submitted to HUD in the previous 10 years; or
- If the Borrower wishes to halt R4R Deposits

When a Full Transfer of Physical Assets occurs, the old Borrower **is not relieved** of filing a final financial statement from the beginning of their fiscal year to the point that HUD issues its Preliminary Approval letter and the transaction is executed. A final financial statement must be filed within 90 days from the date of the actual Transfer of Physical Assets, and if not timely filed, will be subject to Civil Money penalties of \$42,500 (or the amount in effect at the time of the failure to file) for each return not filed.